ECL Framework for Banks: Key Highlights

Staging Criteria for Asset Classification

Stage 1, Stage 2 (significant increase in credit risk) and Stage 3 (defaulted) assets largely as per Ind AS; however, significant levels of “regulatory floor” for provisioning, ranging from the vintage of Stage tag.

Stage 3 classification applies to all facilities to a borrower - that is, once the borrower attains Stage 3, all exposures to the borrower tagged as Stage 3 (aligned with present NPA treatment).

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Restructured accounts shall be upgraded from Stage 3 to Stage 1 with a minimum six month layover at Stage 2, except in case of satisfactory completion of the monitoring period.

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ECL Framework for Banks: Key Highlights

ECL Computation

Stage 2, currently not treated as NPA, attracts 5% minimum ECL, whereas in case of Stage 3 (currently NPA as per IRACP norms), attracts 25% to 100% over a period of 4 years for secured and for unsecured 100% after one year.

Compulsory valuation of collateral for Stage 3 assets for exposure beyond ₹5 crore, once upon classification, and thereafter, every 2 years. Annual valuation in case the collateral is stock.

Fraud facilities require 100% provision, wilful defaulters to attract additional provision of 5%. Currently, additional 5% provisioning is required in case the director's name appears more than once in the LWD.

12-month PD for any instrument shall not be less than 0.05%. If the bank is unable to correctly estimate LGD, LGD will be taken as 65% for the secured portion and 70% for the unsecured portion.

ECL Framework for Banks: Key Highlights

Income Recognition and Inclusion as Regulatory Capital

On Stage 3 assets, while income recognition to be done at effective interest rate on the net-of-write-off value of the exposure, the income so recognised to become additional ECL, thereby neutralising the income recognised. [That it so say, the present position that income recognition ceases on NPAs continues effectively]

Stage 2 and Stage 3 provisions hit P/L of the bank, and not be reckoned as a part of regulatory capital.

To ensure that ECL provisions do not result into capital deficiency, provisions ensure a phased “add back” to Common Equity Tier 1, that is, the additional ECL provision eating regulatory capital will get partial relief over 4 years from 2027-28 (the first year when the ECL framework applies)

ECL Framework for Banks: Key Highlights

Governance Norms

Implementation and functioning of ECL is board responsibility [para 42]; a Board Committee or Committee approved by the board shall oversee the implementation of ECL.

Banks to ensure the following policy documentation:

a. **ECL assessment approach for each exposure or portfolio, justifying the suitability of chosen methods**
b. **Parameters for determination of SICR**
c. **Basis of segmentation for computing ECL on a collective basis for a particular portfolio segment.**
d. **Model validation framework**

Banks to implement a three-stage model risk management framework: Front line operations being handled by model owners, risk management team to identify risk and internal audit to objective assurance on the effectiveness of the first two stages. The same shall be reported to the board and audit committee.

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